

W. Scott Randolph
Director – Regulatory Affairs



September 6, 2002

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Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, DC 20554

**Ex Parte: Federal-State Joint Board on Universal Service, CC Docket No. 96-45;
1998 Biennial Regulatory Review – Streamlined Contributor Reporting Requirements,
CC Docket No. 98-171; Telecommunications Services for Individuals with Hearing and
Speech Disabilities and the Americans with Disabilities Act of 1990, CC Docket No. 90-
571; Administration of the North American Numbering Plan and North American
Numbering Plan Cost Recovery Contribution Factor and Fund Size, CC Docket No. 92-
237, NSD File No. L-00-72; Numbering Resource Optimization, CC Docket No. 99-200;
and Telephone Number Portability, CC Docket No. 95-116**

**Appropriate Framework for Broadband Access to the Internet over Wireline Facilities;
Universal Service Obligations for Broadband Providers, CC Docket No. 02-33**

Dear Ms. Dortch:

On September 5, 2002, Ann Rakestraw, Neal Bellamy and the undersigned met with Eric Einhorn, Diane Law Hsu, Paul Garnett, Narda Jones, Vickie Byrd and Jon Secrest of the Wireline Competition Bureau to discuss various proposals to revise the universal service contribution mechanism. We discussed how a revenue-based system is the best method for assessing universal service contributions, why the Commission should not move to a per-connection approach as suggested by CoSUS and other parties, and stressed that there is not sufficient data on the record to understand current and future impacts on consumers of a per-connection method. The attached material was used in the discussions.

Pursuant to Section 1.1206(a)(1) of the Commission's rules, an original and one copy of this letter are being submitted to the Office of the Secretary. Please associate this notification with the record in the proceedings indicated above. If you have any questions regarding this matter, please call me at (202) 515-2530.

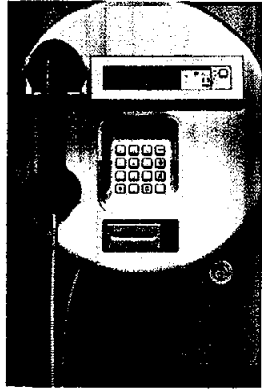
Sincerely,

A handwritten signature in black ink, appearing to read "W. Scott Randolph".

W. Scott Randolph

Attachment

cc:	Eric Einhorn	Narda Jones
	Diane Law Hsu	Jon Secrest
	Paul Garnett	Vickie Byrd



Universal Service Contribution Mechanism



September 2002

A revenue-based system is the best method for assessing universal service contributions

- Consistent with the Act
 - Allows “every telecommunications provider” providing interstate telecommunications service to contribute on an “equitable” and “nondiscriminatory” basis. *See* 47 U.S.C. § 254(d).
- Competitively neutral
 - Allows market forces, rather than regulators, to set prices for services, and thus assessment levels
- Self-weighting approach
 - Contributions are proportional to interstate use by consumers

Concerns with the current system are best addressed through minor adjustments to the revenue-based approach

- Move to a collect and remit system
 - USAC would set the quarterly contribution percentage based on projected fund needs and projections of collected revenues
 - Carriers would remit payments based on USAC percentage applied to interstate revenues actually collected
 - Eliminates problems with uncollectibles
 - Eliminates need to mandate pass-through to ensure contributions
 - Eliminates problem with historical lag

Concerns with the current system are best addressed through minor adjustments to the revenue-based approach (cont.)

- Adopt a flexibly defined safe harbor cap on universal service line item charges
 - Cap must allow carriers to recover administrative costs
 - Cap should be flexibly defined (average, rather than per individual customer) to allow for flat fee charges
- Expand contributor base
 - All broadband providers should contribute to the schools and libraries program
 - Conduct further proceedings to determine whether safe harbors should be revisited, or if other providers of telecommunications services should contribute

Interstate revenues in service bundles can be identified

- Safe harbors already exist for bundles of telecom, CPE, and information (CC Docket 96-61)
- Factors can be readily developed from public data sources to establish parity of contribution and broaden base of contributors
 - DSL prices as surrogate for Cable Modem telecom component
 - Many industry analysts have published data showing state or nationwide average prices for dial tone, CPE, LD, broadband, etc. upon which an average percentage factor could be developed
 - PIU data exists to split intra- and interstate LD revenues
 - require CLECs to contribute as if they also were required to charge an interstate SLC
- If public data sources are not sufficient, the Commission can obtain data from carriers under confidential seal

Revenues are not in a “death spiral”

- Based upon data used by COSUS and other public forecasts of revenue growth, under the current revenue system the contribution percentage will be 7.66% in 2006, with low- and high-side estimates of 6.87% and 8.46%
 - using \$7.9B fund size
 - no change in broadband contribution (only DSL contributes to all fund components)
 - no change to wireless or paging safe harbor
 - revenue forecast assumptions taken from Gartner Group and Insight Corporation publicly available studies

The Commission should not move to a per-connection system

- The per-connection approach proposed by COSUS is unlawful
- Any per-connection approach would create significant new administrative difficulties
 - Any “connection” is difficult to define, especially for multi-line businesses and new services, e.g., Flex-Grow, voice over DSL
 - Carriers track revenues in the normal course of business; they do not track “connections”
 - Because carriers do not now count connections under any of the connection proposals, there will be great difficulty in initial implementation
 - The number of “connections” varies widely day to day
 - USAC will need entirely new auditing techniques and tools, forcing contributing firms to develop new record keeping systems
- Unknown impact on single line and multi-line business customers

There is not sufficient data to understand current and future consumer impact

- COSUS claims the initial MLB contribution would be \$2.50 to \$3.25 for Tier 1 (December 21, 2001, page 10)
- Using 2001 data supplied by COSUS in attacking the Bell South/SBC proposal (July 31, 2002, Worksheet 1), Verizon calculates \$4.77 for Tier 1 MLB
- For 2006, using the same analyst source documents as COSUS, plus other public predictions of trends in connections, VZ calculates the MLB Tier 1 assessment would be \$5.62
- For 2006, using the same analyst source documents as COSUS, plus other public predictions of trends in connections, and the Joint Board's assumption of holding single line \$1 charge constant, Verizon calculates the MLB Tier 1 assessment would be \$6.73

There is not sufficient data to understand current and future consumer impact (cont.)

- The Commission must have sound estimates of contribution assessments based upon data scrutinized in the public record **BEFORE** adopting a decision
- COSUS has not supplied data to support claims of long-term sustainability (growth/decline trends for connections, current/future assessments for single and multi-line)
- Joint Board (August 9, 2002) used “illustrative” data
 - Compare, COSUS July 31, 2002 “Five-Way Comparison” data showing 87 % of PICs for wireline (0.99/1.14) with Joint Board 1A approach using 69 % wireline PICs (87,316/126,894).
 - Joint Board says MLB will “get the benefit of line growth” but using COSUS data and the frozen \$1 single line charge, VZ calculates a huge increase, from \$4.77 to \$6.73.
 - Joint Board 1A shows \$3.40 as initial MLB rate - what basis? COSUS says Tier 1 is between \$2.50 and \$3.25 (December 21, 2001). Using COSUS data, VZ calculates \$4.77 for Tier 1. What is right?

Single line consumer impact for low- and high-volume users

	2002				2006			
	Local	LD	Wireless	Paging	Local	LD	Wireless	Paging
Revenue, High Volume	\$0.41	\$3.64	\$0.87	\$0.44	\$0.50	\$3.83	\$0.92	\$0.46
Revenue, Low Volume	\$0.41	0	\$0.16	\$0.07	\$0.50	0	\$0.17	\$0.07
COSUS	\$1.00	Not assessed	\$1.00	\$0.25	\$1.18	Not Assessed	\$1.18	\$0.30
Joint Board frozen \$1.00	\$1.00	Not assessed	\$1.00	\$0.25	\$1.00	Not Assessed	\$1.00	\$0.25

Assumptions:

- Local service ILEC SLC is currently is an average of \$5.66 (COSUS July 31, 2002 at Worksheet 3), and will be \$6.50 in 2006.
- Long Distance monthly charge is zero for low-volume users, and \$50 for high-volume users.
- Wireless monthly charge is \$15 basic "emergency only" service for low-volume users, and \$80 "Nationwide" package for high-volume users (both using 15% safe harbor).
- Paging monthly charge is \$8 local-only "teenager" service for low-volume users, and \$50 nationwide, toll free for high-volume users (both using 12% safe harbor).
- Revenue contribution percentage is 7.28% for 2002, 7.66% for 2006.

Impact of broadband contributions on assessment percentage

	2006	2006 Low Growth (20% lower)	2006 High Growth (20% higher)
Only DSL contributing to all	7.66%	8.46%	6.87%
Only DSL contributing to only S&L	S/L = 2.18% all = 9.49%	S/L = 2.41% all = 9.97%	S/L = 1.96% all = 9.02%
All broadband contributing to only S&L	S/L = 1.85% all = 9.16%	S/L = 2.10% all = 9.66%	S/L = 1.61% all = 8.68%

Note: The effective percentage contributed equals the "all" percentage for consumers without broadband service, and is between the "S/L" percentage and the "all" percentage for consumers with broadband service (weighting depends on price of broadband and all other interstate services purchased).

The Commission must obtain more information before adopting a connection-based contribution methodology

- FCC order must be based on “substantial evidence,” which doesn’t exist on current record. *See generally AT&T Corp. v. FCC*, 86 F.3d 242, 247 (D.C. Cir. 1996).
- Waiting until implementation phase to learn true consumer impact would constitute arbitrary and capricious decision making.
- Not all carriers currently count connections; all current data figures are just estimates. USAC cannot implement a reliable and workable initial assessment without more data.

Solution

- Address current concerns with interim adjustments to the revenue-based system as Verizon proposes (collect & remit, safe harbor cap on administrative mark-up) and assess all broadband providers on the same basis, while:
 - Gathering reliable data regarding actual number of connections and their growth/decline trends
 - Creating sound estimates of current and future assessment levels on residential and business customers from proposed connection-based method(s)
 - Gathering reliable data and creating sound estimate of revenue-based contribution percentage in the future
 - Gathering reliable data and determining whether other sources of interstate revenues should be included that would contribute to a broader base and greater stability of the revenue system
- Then, select revenue- or connection-based methodology that would withstand challenge and be predictable and sustainable.



Universal Service Contribution Mechanism

**Why the FCC should not adopt
a connection-based method**



September 2002



Universal Service Contribution Mechanism

1. Myth v. Reality

Why the connection-based method doesn't work

2. How would the collect-and-remit proposal work?

3. Impact of requiring broadband providers to contribute to the Schools and Libraries Fund

4. How to identify interstate revenues in bundled services

5. Analysis of CoSUS proposal and contribution factor estimates

6. Legal issues with the CoSUS and Joint Board proposals



September 2002

Myth v. Reality



Why the connection-based method doesn't work

The Coalition for Sustainable Universal Service claims that the current revenue-based assessment mechanism must be changed to a connection-based system. The Coalition raises a number of arguments about why the current method cannot be salvaged and how a new method will benefit customers. This paper examines their arguments and explains why they just do not stand up to scrutiny. The Coalition is playing a shell game, hoping to sell the Federal Communications Commission on an impossible promise – that the FCC can collect more money for the federal universal service fund by charging consumers less.

Issue	✓ Myth	✓ Reality
1. Contributor base	A connection-based method would broaden the base of contributors to universal service.	A connection-based proposal actually narrows the base of contributors, because any future increases in USF charges would have to be shouldered only by local, wireless, and paging customers – and none by long distance.
2. Growth of interstate revenues	Interstate revenues are declining and in a “death spiral.”	When the actual numbers are examined, there is no evidence of a large scale, systematic decline in interstate revenues. The Coalition picks several worst-case scenarios and combines them into an inaccurate picture of the future of interstate revenues. The scenarios cited by the Coalition – if they occurred individually – would only raise the universal service contribution to between 8.1% and 9.3%.
3. Growth of connections	Connections would continue to grow and provide a stable base for assessments.	The Coalition’s assumption is unproven. For the first time in history, wireline connections are shrinking and wireless growth is tapering off. In addition, customers – not connections – ultimately would pay the universal service bill. The amount charged would stay the same regardless of the manner of assessment.
4. Consumer burden	A connection-based method would produce more universal service funds, while decreasing customer contributions to the fund.	FCC staff has estimated that consumers would pay about the same amount no matter what assessment method is used. See NPRM, ¶46. The Coalition acknowledges, in fact, that residential customers now pay less under the revenue-based method than they would under the proposed connection-based method (\$0.96 v. \$1.00). See Coalition Comments, at 62.

Issue	✓ Myth	✓ Reality												
5. Administrative burden	A connection-based method would be simpler to administer.	The FCC would have to define what is a “connection” and how to assess multi-line business customers. Even the Coalition admits that there should be a one-year transition for certain services because “converting to a connection- and capacity-based system will require carriers to deploy scarce IT resources for the development of new contribution and collection systems.” See Coalition Comments at 58.												
6. Impact on interstate revenues	A connection-based method addresses the decline in interstate revenues.	As stated in item 2 above, there is no evidence of a decline in interstate revenues. Shifts in interstate demand – to wireless and broadband, for example – could be addressed just as easily through a revenue-based system. Expanding the base for the schools and libraries fund to include all broadband providers would be a good first step.												
7. Identifying interstate revenues in bundled offerings	A connection-based method would eliminate the problem of identifying interstate revenues in bundled offerings.	Any method selected would have to make assumptions to deal with the issue of bundled offerings. The revenue-based method relies on factors, which can be calculated from readily available data. Such factors would produce fewer market distortions than a connection-based method.												
8. Carrier contributions	A connection-based method would provide a “fair basis for assessments.”	Under the Coalition’s proposal, long distance carriers would shift from being majority contributors to contributing almost nothing. See NPRM, ¶59. <table><tr><th>Method</th><th>IXCs</th><th>LECs</th><th>Wireless</th></tr><tr><td>Revenue-based</td><td>63%</td><td>23%</td><td>14%</td></tr><tr><td>Connection-based</td><td>0%</td><td>76%</td><td>24%</td></tr></table>	Method	IXCs	LECs	Wireless	Revenue-based	63%	23%	14%	Connection-based	0%	76%	24%
Method	IXCs	LECs	Wireless											
Revenue-based	63%	23%	14%											
Connection-based	0%	76%	24%											

Verizon recognizes that there are problems in the current system and has proposed targeted solutions to the FCC to address them:

- Uncollectibles / lag time – The FCC should maintain a revenue-based system, but adopt a collect-and-remit process based on current revenues. Under such a system, USAC would set the quarterly contribution level based on projected needs. Carriers then would remit payment based upon that percentage as applied to revenues actually collected from all customers.
- Broadening the base – As a first minimum step, the FCC should require all providers of broadband services – including cable modem, fixed wireless, and satellite providers – to contribute to the schools and libraries fund. Today, only DSL providers contribute to the entire universal service fund. The FCC also should begin a proceeding aimed at ensuring that all providers of interstate services are contributing an appropriate amount.

Stripped of all the rhetoric, the Coalition's connection-based proposal would virtually eliminate contributions from long distance carriers that generate the most interstate revenues and shift the burden to local exchange companies and wireless carriers. The Coalition is urging the FCC to engage in an open-heart operation to save the universal service system when all that is required is minor surgery.

How would the collect and remit proposal work?

Current process	Verizon's proposal
<ol style="list-style-type: none"> 1. On Form 499, all providers of interstate telecommunications services report their gross billed interstate revenues for each quarter. The amount billed to recover contributions is reported on an annual basis. 2. The Universal Service Administrative Company (USAC) projects the funding need for the next quarter of the year. 3. The FCC establishes the contribution factor for the next quarter by dividing the projected funding need by the total industry interstate revenues from the past quarter of the year (including a 1% carrier uncollectible adjustment). The current factor is 7.28%. 4. This results in a contribution factor that is assessed on a six-month time lag. For example, the gross billed interstate revenues for the first quarter of the year are reported in the second quarter. The anticipated funding need for the third quarter is also developed during the second quarter. A contribution factor for the third quarter is calculated by dividing the projected funding need by the total industry interstate revenues from the first quarter. This contribution factor is used by firms to develop a charge that is billed in the third quarter. 5. Contributing firms develop their next quarterly contribution charge assessed upon their customers by considering: whether their revenues are increasing or decreasing; their uncollectibles; administrative expenses associated with billing, collecting and remitting monies to the administrator; and other factors (e.g., their projection of billable units during the next quarter). 6. In some cases, these adjustments have resulted in billing an amount that is substantially different than the contribution factor published by the FCC. 	<ol style="list-style-type: none"> 1. Form 499 would be revised to require interstate telecommunications service providers to report net interstate revenues actually received from customers (not including the amount that recovers the providers' contributions to the federal universal service fund), rather than gross billed interstate revenues. 2. Each quarter, all providers of interstate telecommunications services would report the net amount of interstate revenues received from their customers (not including the amount that recovers the providers' contributions to the federal universal service fund) during the previous quarter on the revised Form 499. 3. USAC would project the funding need for the next quarter of the year. 4. USAC would incorporate both carrier and end user uncollectible factors, and would project total industry interstate revenues that would actually be received by contributing telecommunications firms for the next quarter. This projection would use statistical methods similar to those successfully used by the FCC staff and by NECA. This projection would be reasonably accurate at the start, and would become more so as additional data points become available and more experience is gained. 5. The FCC would develop the contribution factor for the next quarter by dividing the projected funding need by projected total industry interstate revenues to be collected from consumers. 6. Firms would develop their charge to customers based upon the contribution factor. This charge could be developed as either the published contribution percentage times the monthly interstate charge on the individual bill, or as a flat monthly amount reasonably reflecting the average interstate charges for a class of customers, such as single line residential and business customers. (Verizon uses the latter approach because it is more stable and predictable for consumers, and costs less.) 7. As today, contributing firms would be able to mark up the contribution factor by a small amount to reflect administrative expenses solely related to billing, collecting and remitting to the fund administrator. This administrative markup should be limited to a "safe harbor" amount (typically 1% to 3% in state programs). The FCC would develop the administrative "safe harbor" level and could require contributing firms to justify any administrative mark up above the "safe harbor" level. <ul style="list-style-type: none"> ■ Because the contribution factor already reflects net revenues, there is no need for an uncollectible markup. 8. Firms that add a contribution charge to their bills would label it to alert consumers that it represents recovery of contributions to the federal universal service program. Typical line item labels would include: "Federal Universal Service Contribution," "Federal Universal Service Fee," or "Universal Connectivity Fee." 9. Contributing firms would remit to the fund administrator an amount equal to the contribution percentage times their actual interstate revenues for a quarter (not including the amount that recovers the firm's contributions to the federal fund). This means a firm could choose to not charge a customer for competitive or other reasons, but would still have an obligation to provide contribution for that customer's interstate revenue amount. <ul style="list-style-type: none"> ■ Because the administrative safe harbor amount would be the only mark up permitted, firms would not be able to make up from some customers amounts not charged to other customers. ■ Because contributions for each firm are based on their current revenues, there is no need for contributors to adjust their charges to customers for declining or increasing revenues.

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July 2, 2002

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
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Ex Parte: **Federal-State Joint Board on Universal Service, CC Docket No. 96-45; 1998 Biennial Regulatory Review – Streamlined Contributor Reporting Requirements, CC Docket No. 98-171; Telecommunications Services for Individuals with Hearing and Speech Disabilities and the Americans with Disabilities Act of 1990, CC Docket No. 90-571; Administration of the North American Numbering Plan and North American Numbering Plan Cost Recovery Contribution Factor and Fund Size, CC Docket No. 92-237, NSD File No. L-00-72; Numbering Resource Optimization, CC Docket No. 99-200; and Telephone Number Portability, CC Docket No. 95-116**

Appropriate Framework for Broadband Access to the Internet over Wireline Facilities; Universal Service Obligations for Broadband Providers, CC Docket No. 02-33

Dear Ms. Dortch:

In comments filed in the Commission's Universal Service and Broadband proceedings, Verizon has proposed that all broadband providers be required contribute to only the school and library portions of the federal universal service program. This approach would create competitive neutrality between broadband providers that is noticeably absent in today's contribution method, and would broaden the base of contributors to ensure stability of the fund as the industry is transformed over the next few years.

The schools and library program greatly expands the customer base to which broadband providers can sell their services, so it is appropriate for broadband providers to contribute to furtherance of that program. Limiting broadband contributions to only the school and library portion also moots potential arguments that if broadband providers contribute to all portions of the federal program, broadband services should also be supported by the fund.

In response to questions from certain members of the Federal-State Joint Board on Universal Service, Verizon has estimated the impact of including all broadband revenues in only

the school/library portion of the federal universal service program. Using publicly available information gathered by Verizon, it is estimated that the 3Q2002 revenues for DSL that now contribute to all components of the federal universal service programs are approximately \$700M. Total cable modem revenues are estimated to be approximately \$1.4B for the same 3Q2002.

If cable modem, DSL and all other broadband service revenues were included in the calculations for only the schools and library components of the federal universal service program (removing DSL from support for high cost and other program components), the contribution factor would become bifurcated. If the fund size and all other revenues are held constant, Verizon estimates the bifurcated factors would be approximately 2.6% for the school and library portion, and 4.6% for all other components. Customers with broadband service would contribute 2.6% of only their broadband revenues, and 7.2% (2.6% + 4.6%) of all their other interstate revenues. For consumers with broadband service, the overall contribution would be less than 7.2% of their total interstate revenues.

Attached is a chart that shows the consumer impact of adopting Verizon's bifurcated universal service contribution approach. For demonstration purposes, it is assumed that a consumer has \$15 per month charges for interstate long distance, \$7.50 per month charges for interstate wireless (15% of a hypothetical \$50 service package), \$6.00 per month Subscriber Line Charge (SLC) for ILEC local service customers, and that both cable modem service and DSL have the same market price of \$40.

The "Today" upper portion of the attached chart shows the disparity in contribution amounts (from \$1.64 to \$4.99 per month) that result from the regulatory classification of the service providers chosen by the consumer. The "Verizon Proposal" lower portion of the chart addresses and corrects much of that disparity by having: (1) all broadband revenues contributing 2.6%, and (2) all other interstate revenues contributing 7.2%. The overall contribution from ILEC customers with broadband service would be about 4.5% in this hypothetical example ($2.6\% \times \$40$ plus $7.2\% \times \$28.50$, divided by $\$68.50$) irrespective of whether the broadband service was DSL or cable modem.

Note that disparity remains in the amount consumers contribute if a CLEC is chosen as the local service provider rather than an ILEC. This disparity results because ILECs are required to charge an interstate SLC, and CLECs are not required to do so. This disparity resulting from regulatory treatment of firms competing to provide local service could be corrected if CLECs were required to report as interstate revenues an amount approximately equal to a statewide or nationwide average SLC.

Unlike other plans, Verizon does not propose that Internet Service Providers (ISPs) offering dial up services be required to report or to contribute to the federal program administrator. Neither does Verizon propose that ISPs that purchase DSL or access to a cable modem platform and sell their information services to end users be required to report and contribute to the federal program administrator. Instead, just as is common practice today, ILECs providing DSL to ISPs would report the DSL interstate revenues, contribute to the administrator based on those revenues, and pass their contributions through to the ISP as a line item on the bill for DSL. For example, if the DSL rate is \$40 per month, today Verizon recovers its contributions through a line item charge of 7.2% times \$40, or \$2.88. Under the Verizon proposal, the pass through charge on the ISP's bill for DSL would be reduced to approximately 2.6% times \$40, or \$1.04. And, under the Verizon

Ms. Marlene H. Dortch
July 2, 2002
Page 3

proposal, cable modem service providers would follow the same reporting and contribution procedures as ILECs that provide DSL.

The inclusion of all broadband revenues for contributions only to the school and library portion of the federal program does not significantly reduce the overall contribution factor today. However, because broadband services are expected to experience a huge growth rate, including all broadband revenues will stabilize the contribution base and will have an impact the contribution factor in the future. According to a recent study entitled *U.S. and Canada Broadband Multimedia Review 2002-2008* prepared by C.A. Ingley & Co., 60 million households will subscribe to residential broadband by 2008. Given today's U.S. penetration of less than 10 million subscribers, this equates to approximately a six-fold increase in less than six years. See *Communications Daily*, June 19, 2002, at 7. Further, according to a recent Solomon-Wolff survey, broadband services will make up 30% of Internet connections compared with 6% three years ago. The study predicted that trend would continue, with broadband accounting for more than half of home Internet service connections by early 2004. See *Communications Daily*, June 25, 2002, at 9.

The anticipated large growth rate for broadband services (and revenues) will act to reduce the contribution from broadband customers, and depending on how rapidly the overall funding need grows as compared to broadband growth, could mitigate the effect of growth in funding needs for all consumers. For example, Verizon estimates that if the total cable modem service and DSL revenues doubled (holding fund size and all other revenues constant), this would result in a contribution rate of approximately 2.4% for the school and library portion, and 4.6% for all other components. If a consumer had broadband service in addition to other interstate services, that consumer would contribute 2.4% times their broadband revenues, plus 7.0% (2.4 + 4.6) times all other interstate revenues.

Pursuant to Section 1.1206(a)(1) of the Commission's rules, and original and one copy of this letter are being submitted to the Office of the Secretary. Please associate this notification with the record in the proceedings indicated above. If you have any questions regarding this matter, please call me at (202) 515-2530.

Sincerely,



W. Scott Randolph

Attachment

cc: Carol Matthey
Eric Einhorn
Diane Law Hsu
Paul Garnett
John Secrest
Vickie Byrd
Matt Brill
Kyle Dixon
Jordan Goldstein
Dan Gonzalez

**Impact on Universal Service Contribution Resulting From the Regulatory Classification
of the Service Providers Chosen by a Consumer**

Today

Interstate Revenue from	ILEC Customer without Broadband	CLEC Customer without Broadband	CLEC Customer with Cable Modem	ILEC Customer with Cable Modem	ILEC Customer with DSL
Subscriber Line Charge	\$6.00	\$0.00	\$0.00	\$6.00	\$6.00
DSL*					\$40.00
Cable Modem Service*			\$40.00	\$40.00	
Interstate Long Distance	\$15.00	\$15.00	\$15.00	\$15.00	\$15.00
Wireless 15% of \$50 bundle	\$7.50	\$7.50	\$7.50	\$7.50	\$7.50
Contribution % without mark-up	7.2805%	7.2805%	7.2805%	7.2805%	7.2805%
Universal Service Contribution	\$2.07	\$1.64	\$1.64	\$2.07	\$4.99

Verizon Proposal**

Interstate Revenue from	ILEC Customer without Broadband	CLEC Customer without Broadband	CLEC Customer with Cable Modem	ILEC Customer with Cable Modem	ILEC Customer with DSL
Subscriber Line Charge	\$6.00	\$0.00	\$0.00	\$6.00	\$6.00
DSL*					\$40.00
Cable Modem Service*			\$40.00	\$40.00	
Interstate Long Distance	\$15.00	\$15.00	\$15.00	\$15.00	\$15.00
Wireless 15% of \$50 bundle	\$7.50	\$7.50	\$7.50	\$7.50	\$7.50
Contribution % for Broadband revenues (for School & Library)	2.6290%	2.6290%	2.6290%	2.6290%	2.6290%
Contribution % for all other revenues	7.2480%	7.2480%	7.2480%	7.2480%	7.2480%
Universal Service Contribution	\$2.07	\$1.63	\$2.68	\$3.12	\$3.12

* DSL and Cable Modem price assumed to be equal

** Verizon does not endorse continuation of the disparity in contribution that results from the requirement for ILECs to charge an interstate SLC.
This disparity can be addressed by requiring CLECs to report as interstate revenues an amount equal to a statewide or nationwide SLC.



How to identify

Interstate revenues in bundled offerings

There are methods the Federal Communications Commission could use to identify the interstate telecommunications revenue portion of service bundles, including studies of actual interstate usage, development of industry-wide or state-wide apportionment factors, and creation of additional "safe harbors."

Verizon favors adoption of a factor approach to avoid the need for periodic studies of actual usage or extensive billing system modifications to capture data on an ongoing basis for actual reporting. A factor that must be used by all firms competing for the same customers with similar service bundles would place them on an equal footing and reduce the need for audits or similar Commission oversight. Any method used, however, should ensure competitive parity.

Below, Verizon identifies two ways that factors could be developed: (1) based on actual usage and revenue, or (2) upon market price analysis.



Developing factors based on actual usage/revenues

There is a great deal of public information both on market prices and average usage levels for local, wireless, information, and long distance services. Many analysts have studied each of these services and published summary data showing average prices, usage statistics, trends, and projections. Plus, the FCC and state commissions already have accumulated a large body of data to regulate traditional telecommunications services.

Some types of data that the FCC may obtain:

1. Firms designing bundles have predictions of usage of the individual components, and track actual usage for marketing adjustments and network planning purposes.
2. Most, if not all, firms offering long distance can provide individual call detail to their customers. Thus, a firm's billing system continues to record originating and terminating telephone numbers on long distance calls. Statistical sampling methods could be used to develop statewide or nationwide averages of intrastate versus interstate usage and revenues.
3. Both ILECs and IXC's have a great deal of data on historical Percent Interstate Usage (PIU) amounts. This data could be used to develop either a statewide or nationwide factor.
4. The underlying data already exists to show the interstate revenue components of ILEC bundled offerings. ILECs providing wireline services are required to file publicly available tariffs for their services. Further, state regulations

generally prohibit any kind of package discounts from applying to local service components. And, because the largest ILECs must offer long distance, wireless, and information services through separate affiliates or under accounting separation, the data exists to separately track revenues from those services.

5. Wireless carriers already have demonstrated their ability to conduct special studies to determine the interstate portion of their revenues. This ability exists because call detail is normally provided to their customers, and the wireless industry has developed methods to classify calls with uncertain jurisdiction.



Developing factors based on market price analysis

Another approach would be to rely upon analysis of market prices to identify an amount representing the interstate portion. Examples of readily available sources of information are sales collateral, tariffs, and advertising, including Internet sites.

Examining a family of bundled offerings by a firm can yield insights into the value of various components the firm expects the market will place on each. For example, the MCI Neighborhood offers one package that does not include long distance and another package that does. The price difference provides strong indication of the average revenues associated with the long distance service that MCI expects will occur. The intra- and interstate portions

if the average long distance revenues could be established using available PIU or statistical data as described above.

Similarly, wireless service plans that include a fixed number of minutes generally offer different calling scope options. Comparison of the price for wireless calling plans that are statewide versus nationwide would provide another indication of the market value of the ability to make interstate calls without additional charges. For example, if a wireless carrier offered a statewide plan with 400 minutes a month for \$40, and a nationwide plan with 400 minutes a month for \$50, it would be logical to assume that the \$10 difference amounts to the interstate portion the wireless carrier expects would occur.



Any method must be adjusted to ensure competitive parity

Any method for allocating costs between inter- and intra-state revenues must be designed to ensure competitive parity, which does not exist in the current system for CLEC Subscriber Line Charge (SLC) or broadband.

Both CLEC and ILEC customers should contribute based upon an assumed interstate revenue amount equivalent to an interstate SLC

Currently, ILECs are required to apply an interstate SLC on all local service customers, to report the SLC revenues as interstate revenues, and to contribute to the federal universal service program based upon those interstate revenues.

For example, Verizon's current contribution is about \$0.55 per month for residential local service customers. CLECs, however, are not required to apply an interstate SLC. Although a few CLECs do charge a SLC and report interstate revenues, many do not. As a result, many CLEC residential local service customers pay approximately \$0.55 per month less to the federal universal service program than an ILEC customer.

Because the business SLC is capped at a much higher level, and since many CLECs have focused their efforts on the business market, the contribution disparity is much greater for business customers.

The CLEC-ILEC customer disparity results not only in less money to the universal service fund, but, all else being equal, also gives CLECs a competitive price advantage purely as a result of FCC rules.

To achieve parity, the FCC could develop either an average SLC revenue on a state- or nationwide basis, and require firms offering residence and business local services that are not subject to the FCC's Part 69 rules to report each month as interstate revenues an amount equal to a state- or nationwide average SLC. Such firms would not be required to charge a SLC, but only to report an interstate revenue amount for contribution purposes that is equivalent to the state- or nationwide SLC revenue amount selected by the Commission.

All broadband providers should contribute equally

Currently, only DSL providers – and not the providers of other broadband services (e.g., cable modem and satellite) – contribute to the universal service fund. This disparate treatment undermines the principles of competitive neutrality and should be remedied.

If the FCC requires all broadband service providers to contribute to the universal service program, and if the FCC were to base such contributions only on the telecommunications portion of the bundled service (the underlying telecommunications used to deliver Internet content), the FCC could readily develop a factor through several alternative methods that would remove the competitive disparity for ILEC-provided broadband service that exists today, solely as a result of traditional regulation applied to ILECs:

1. ILECs offer DSL without content service to both ISP and end user customers. The FCC could gather pricing information from ILEC DSL offerings to identify the state- or nationwide average DSL price. The average state- or nationwide DSL price could be used as a proxy for the telecommunications portion of other broadband services, and all other broadband service providers could be required to contribute each month an amount equal to the USAC contribution percentage times that state- or nationwide average DSL amount.
2. Alternatively, the FCC could gather information on the prices charged for cable modem service (e.g., from websites such as <http://www.cable-modem-internet-access.com/>) and develop a factor based on the portion of the total cable modem service price represented by the average DSL price.
3. A third alternative would be to compare the average prices charged by ISPs who sell their content service bundled with DSL to end users with the DSL transport-only average prices.
4. A fourth alternative would be to compare the average prices charged by cable companies for cable modem service with the average prices charged by cable companies to non-affiliated ISPs that reach end users over the cable network.

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Table 1: Per Line Contributions Based on CoSUS Filing

Category/Year	2001	SOURCE	2006 Estimate	SOURCE	2006 Low Growth	Assumption	2006 High Growth	Assumption
USF	6,000,000,000	Note 1	7,900,000,000	Note 3	7,900,000,000	Note 3	7,900,000,000	Note 3
ILEC Res Lines	114,345,035	Note 1	109,843,831	Note 4	103,358,855	Note 8	120,177,781	Note 10
ILEC Lifelines	5,886,779	Note 2	5,655,045	Note 4	5,321,182	Note 8	6,187,064	Note 10
CLEC Switched Lines	13,356,000	Note 1	12,830,240	Note 4	12,072,766	Note 8	14,037,290	Note 10
Wireless Handsets	128,374,512	Note 1	199,000,000	Note 5	181,740,924	Note 9	214,376,713	Note 11
Pager Lines	41,535,000	Note 1	11,242,628	Note 6	8,036,680	Note 9	15,398,679	Note 11
ILEC Switched Business Lines	43,369,395	Note 1	41,662,154	Note 4	39,202,498	Note 8	45,581,670	Note 10
ILEC Centrex Lines	16,160,117	Note 1	15,523,972	Note 4	14,607,466	Note 8	16,984,445	Note 10
ILEC Special DS0	2,358,500	Note 1	772,833	Note 7	598,004	Note 9	986,353	Note 11
ILEC Digital 64kb/s-1.544Mb/s	1,515,200	Note 1	496,501	Note 7	384,183	Note 9	633,675	Note 11
ILEC Digital 1.5 Mb/s-45Mb/s	76,600	Note 1	23,570	Note 7	18,178	Note 9	30,173	Note 11
ILEC Digital > 45Mb/s	18,600	Note 1	141,244	Note 7	100,035	Note 9	195,035	Note 11
Joint Board Proposal								
Res and Wireless Per Line (Fixed)	\$ 1.00		\$ 1.00		\$ 1.00		\$ 1.00	
Multi Bus Per Line	\$ 4.77		\$ 6.73		\$ 7.94		\$ 5.47	
CoSUS Proposal								
Res and Wireless Per Line (Equal Sharing)	\$ 1.00		\$ 1.18		\$ 1.28		\$ 1.06	
Multi Bus Per Line	\$ 4.77		\$ 5.62		\$ 6.13		\$ 5.08	

Note 1: Worksheet 1 of the Ex-Parte filed by CoSUS on July 31, 2002.

Note 2: Table 2.5 Universal Service Monitoring Report, CC Docket No. 98-202, October 2001, FCC

Note 3: Page 3 of CoSUS filing on December 21, 2001.

Note 4: Gartner group forecasts: Total residential voice lines CAGR of -0.8%. Same CAGR applied to switched business lines.

(Fixed Public Network Services Market Trends: US 2001-2006, Figure 5-4, May 21, 2002, Gartner.)

Note 5: Based on Figure II-12, The Telecommunications Industry & Profitability: A Survival Guide 2002-2007, June 2002, Insight Research Corporation.

Note 6: Paging CAGR = -23% based on Verizon filing in support of the current contribution mechanism, October 2001.

Note 7: Table II-1, The Telecommunications Industry & Profitability: A Survival Guide 2002-2007, June 2002, Insight Research (CAGR: DS1 = -20%, DS3 = -21%, OC3+ = 50%)

Note 8: Assumes a CAGR of -2% for all voice lines.

Note 9: Assumes a 20% lower change compared to Baseline 2006 forecasts.

Note 10: Assumes a CAGR of 1% for all voice lines.

Note 11: Assumes a 20% higher change compared to Baseline 2006 forecasts.

Table 2A: Contribution Factor Based on Interstate Revenue (DSL Contributing to all USF)

Category/Year	2001	SOURCE	2006 Estimate	SOURCE	2006 Low Growth	Assumption	2006 High Growth	Assumption
USF	\$ 6,000,000,000	Note 1	\$ 7,900,000,000	Note 3	\$ 7,900,000,000	Note 3	\$ 7,900,000,000	Note 3
Fixed Local Service Providers less Broadband	\$ 13,260,365,025	Note 2	\$ 15,597,575,154	Note 4	\$ 15,149,827,828	Note 8	\$ 16,055,846,855	Note 9
Broadband Providers	\$ 3,955,634,975	Note 3	\$ 25,883,504,842	Note 5	\$ 18,744,741,907	Note 8	\$ 35,048,366,103	Note 9
Wireless Service Providers	\$ 7,880,000,000	Note 2	\$ 13,398,314,065	Note 6	\$ 12,235,998,338	Note 8	\$ 14,647,326,140	Note 9
Toll Service Providers	\$ 53,960,000,000	Note 2	\$ 48,279,883,663	Note 7	\$ 47,300,608,241	Note 8	\$ 49,275,311,673	Note 9
All Providers	\$ 79,100,000,000	Note 2	\$ 103,159,277,725	SUM	\$ 93,431,176,314	SUM	\$ 115,026,850,771	SUM
USF Contribution Factor	7.59%		7.66%		8.46%		6.87%	

Table 2B: Contribution Factor Based on Interstate Revenue (DSL Contributing only to Schools and Libraries)

Category/Year	2001	SOURCE	2006 Estimate	SOURCE	2006 Low Growth	Assumption	2006 High Growth	Assumption
USF	\$ 6,000,000,000	Note 1	\$ 7,900,000,000	Note 3	\$ 7,900,000,000	Note 3	\$ 7,900,000,000	Note 3
Schools and Libraries	\$ 2,250,000,000		\$ 2,250,000,000		\$ 2,250,000,000		\$ 2,250,000,000	
USF Contribution Factor for Broadband	2.84%		2.18%		2.41%		1.96%	
USF Contribution Factor (All less Broadband)	7.83%		9.49%		9.97%		9.02%	

Note 1: Worksheet 1 of the Ex-Parte filed by CoSUS on July 31, 2002.

Note 2: Table 12, Industry Analysis Division's Telecommunications Industry Revenues, January 2002, FCC Less Broadband revenue referenced in Note 3.

Note 3: Table 1-4, Fixed Public Network Services: United States, 2000-2006, Gartner Inc. Only DSL

Note 4: Table 1-3, Fixed Public Network Services: United States, 2000-2006, Gartner Inc. (CAGR = 3.3%)

Note 5: Table 1-4, Fixed Public Network Services: United States, 2000-2006, Gartner Inc. Includes DSL (CAGR = 45.6%) and 60% of Cable Modem Revenue (CAGR = 37.6%)

Note 6: CAGR = 11.2% between 2002 and 2006 in Figure II-14, The Telecommunications Industry & Profitability: A Survival Guide 2002-2007, June 2002, Insight Research Co.

Note 7: Table 1-2, Fixed Public Network Services: United States, 2000-2006, Gartner Inc. (CAGR = -2.2%)

Note 8: Assumes a 20% lower change compared to Baseline 2006 forecasts.

Note 9: Assumes a 20% higher change compared to Baseline 2006 forecasts.

Table 2C: Contribution Factor Based on Interstate Revenue (Broadband Contributing only to Schools and Libraries)

Category/Year	2001	SOURCE	2006 Estimate	SOURCE	2006 Low Growth	Assumption	2006 High Growth	Assumption
USF	\$ 6,000,000,000	Note 1	\$ 7,900,000,000	Note 3	\$ 7,900,000,000	Note 3	\$ 7,900,000,000	Note 3
Schools and Libraries	\$ 2,250,000,000		\$ 2,250,000,000		\$ 2,250,000,000		\$ 2,250,000,000	
USF Contribution Factor for Broadband	2.84%		1.85%		2.10%		1.61%	
USF Contribution Factor (All less Broadband)	7.83%		9.16%		9.66%		8.68%	

Note 1: Worksheet 1 of the Ex-Parte filed by CoSUS on July 31, 2002.

Note 2: Table 12, Industry Analysis Division's Telecommunications Industry Revenues, January 2002, FCC Less Broadband revenue referenced in Note 3.

Note 3: Table 1-4, Fixed Public Network Services: United States, 2000-2006, Gartner Inc. Only DSL

Note 4: Table 1-3, Fixed Public Network Services: United States, 2000-2006, Gartner Inc. (CAGR = 3.3%)

Note 5: Table 1-4, Fixed Public Network Services: US, 2000-2006, Gartner. DSL (CAGR=45.6%), Cable Modem (CAGR=37.6%), Fixed Wireless (CAGR=46.9%), Satellite (CAGR=28.4%).

Note 6: CAGR = 11.2% between 2002 and 2006 in Figure II-14, The Telecommunications Industry & Profitability: A Survival Guide 2002-2007, June 2002, Insight Research Co.

Note 7: Table 1-2, Fixed Public Network Services: United States, 2000-2006, Gartner Inc. (CAGR = -2.2%)

Note 8: Assumes a 20% lower change compared to Baseline 2006 forecasts.

Note 9: Assumes a 20% higher change compared to Baseline 2006 forecasts.

W. Scott Randolph
Director – Regulatory Affairs



August 29, 2002

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Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
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**Ex Parte: Federal-State Joint Board on Universal Service, CC Docket No. 96-45;
 1998 Biennial Regulatory Review – Streamlined Contributor Reporting
 Requirements, CC Docket No. 98-171; Telecommunications Services for
 Individuals with Hearing and Speech Disabilities and the Americans with
 Disabilities Act of 1990, CC Docket No. 90-571; Administration of the North
 American Numbering Plan and North American Numbering Plan Cost Recovery
 Contribution Factor and Fund Size, CC Docket No. 92-237, NSD File No. L-00-72;
 Numbering Resource Optimization, CC Docket No. 99-200; and Telephone
 Number Portability, CC Docket No. 95-116**

Dear Ms. Dortch:

On August 28, 2002, Ann Rakestraw, Ed Shakin and the undersigned, met with John Rogovin and Debra Weiner of the Office of General Counsel to discuss proposals to revise the methodology for contributing to the universal service funds. We explained how the per-connection proposal advocated by the Coalition for Sustainable Universal Service (CoSUS) would violate Section 254(d) of the Act because it would not have "every" carrier "contribute on an equitable and nondiscriminatory basis" to support universal service. The CoSUS proposal is also contrary to the decision reached in *Texas Office of PUC v. FCC*, 183 F.3d 393 (5th Cir. 1999), because it requires the majority of support to come from intrastate services and would remove any obligation of providers of interstate long distance services to contribute. Further, we noted that the record in this proceeding lacks sufficient evidence to support a move to a per-connection assessment, including the absence of data and other information to adequately assess future impacts on consumers, especially multi-line business customers.

We also discussed how the recommendation of the State Members of the Universal Service Joint Board poses additional legal problems in that it would result in the creation of implicit subsidies in violation of Section 254(e) and discriminatory treatment in violation of Section 202(a).

The attached material was used in the discussions.

Pursuant to Section 1.1206(a)(1) of the Commission's rules, and original and one copy of this letter are being submitted to the Office of the Secretary. Please associate this notification with the record in the proceedings indicated above. If you have any questions regarding this matter, please call me at (202) 515-2530.

Sincerely,

A handwritten signature in black ink, appearing to read "W. Scott Randolph", written in a cursive style.

W. Scott Randolph

Attachment

cc: John Rogovin
Debra Weiner
Linda Kinney

Universal Service
Contribution Mechanism
Legality Concerns With the Proposals by
COSUS and the State Joint Board Members

August 2002



The Per-Connection Proposal Endorsed by COSUS Is Unlawful for Several Reasons

- The Fifth Circuit has specifically found that, in implementing the current, revenue-based system, the Commission “reasonably applied the principle of equitable and nondiscriminatory contribution by requiring contributions from *all* telecommunications providers.” *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 623 (5th Cir. 2000) (emphasis added).
- The COSUS proposal violates 47 U.S.C. § 254(d) because it does not have “every” carrier “contribute on an equitable and nondiscriminatory basis.”
 - Applying a discriminatory formula in a neutral fashion is not “equitable and nondiscriminatory” treatment.
 - Just because some of the large long distance carriers will still contribute *something* to universal service program does not mean that they will contribute on an “equitable and nondiscriminatory basis.”
 - While COSUS argues that its proposal is “competitively neutral,” even if true, that is a necessary, not sufficient, requirement for meeting the “equitable and nondiscriminatory” test.

The Per-Connection Proposal Endorsed by COSUS Is Unlawful for Several Reasons (cont'd)

- In *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 434 (5th Cir. 1999), the court noted that § 254(d)'s equitable and nondiscriminatory requirement “also refers to the fairness in the allocation of contribution duties.” Here, those duties would be disproportionately borne largely by local, wireless, and paging carriers – and not by long distance or other carriers.
- The COSUS proposal also violates § 254(d) because a carrier may only be exempt from contribution if its “*activities* are limited to such an extent” that its contribution would be de minimis.
 - The Commission cannot set a discriminatory formula that would simply *result* in certain carriers’ “assessment” becoming de minimis.
 - COSUS admits that “there are likely some telecommunications carriers that provide interstate telecommunications, including standalone dial-around carriers and standalone long distance resellers, that would not be required to make a contribution under the CoSUS formula.” Letter from John Nakahata, COSUS, to Marlene Dortch, FCC, at 4 (filed 8/22/2002).

The Per-Connection Proposal Endorsed by COSUS Is Unlawful for Several Reasons (cont'd)

- The COSUS proposal violates *Texas Office of PUC v. FCC*, 183 F.3d 393 (5th Cir. 1999), because it requires the majority of support to come from intrastate, rather than interstate, services. Per-connection increases support required by intrastate providers and removes obligations from providers of interstate long distance services. By using a method that relies upon intrastate services and their revenues, it “easily constitutes a ‘charge . . . in connection with intrastate commerce,’” in violation of § 2(b). 183 F.3d at 447.
- The record “lacks substantial evidence” to support a move to *any* per-connection proposal at this time. *See generally AT&T Corp. v. FCC*, 86 F.3d 242, 247 (D.C.Cir.1996). On the current record, there is not “substantial evidence” – or, indeed any real data – regarding the future impact a per-connection approach would have on customers, especially multi-line business customers.

The Recommendation of the State Members of the Joint Board Poses Additional Legal Problems

- The recommendation of state Joint Board members, to freeze universal service charges to residential end users and impose all future increases on multi-line business customers for the next five years, and to prohibit carriers from recovering administrative costs, presents additional legal problems.
- Imposing future USF increases only on multi-line business customers violates the Act because:
 - It creates an implicit subsidy, by placing all future increases in universal service charges on multi-line business customers, contrary to the Act's requirement that universal service support be "explicit and sufficient." 47 U.S.C. § 254(e). The Commission receives no *Chevron* step-two deference on this issue, because "the plain language of §254(e) does not permit the FCC to maintain *any* implicit subsidies for universal service support." *Texas Office of PUC*, 183 F.3d at 425.

The Recommendation of the State Members of the Joint Board Poses Additional Legal Problems (cont'd)

- It is not “specific, predictable, and sufficient.” *See* 47 U.S.C. §254(d) With the current record, it is impossible to predict the initial impact on multi-line businesses, much less the future impact.
- It arguably requires carriers to make “discriminatory” preferences, in violation of 47 U.S.C. § 202(a).
- Failing to let carriers pass on administrative costs will lead to implicit subsidies, contrary to the Act’s directive that universal service support “should be explicit and sufficient to achieve the purpose of this section.” 47 U.S.C. § 254(e). Without allowing carriers to recover these administrative costs, the contribution method is neither “explicit” nor “sufficient.”

Conclusion

- More than 25 commenters questioned the lawfulness of the COSUS proposal. It is sure to face legal challenges if adopted.
- The ex parte recommendation by the state members of the Joint Board only adds to the legal problems of the COSUS proposal.
- There is not a sufficient record to move to *any* per connection method at this time, because there does not yet exist “sufficient evidence” regarding the costs and benefits of such a system.